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IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NEW YORK
ROCHESTER DIVISION

THE UNITED STATES OF AMERICA,

-versus-

DOCKET NOS: 15-CR-227
06-CR-6007

RICHARD PETIX,

Defendant.

TRANSCRIPT OF SENTENCING
BEFORE THE HONORABLE CHARLES J. SIRAGUSA
UNITED STATES DISTRICT JUDGE
WEDNESDAY, SEPTEMBER 13, 2017

A p p e a r a n c e s:

On Behalf of the Government:

Richard Resnick, Assistant US Attorney
Grace Carducci, Assistant US Attorney

On Behalf of the Defendant:

Mathew Lembke, Esq. and Stephen Leonardo, Esq.

On Behalf of the Probation Department:

Dave Spogen and Ivette Hernandez

R e p o r t e d B y:

Briana L. Jeffords

1 (Whereupon, the proceeding commences at 11:02 a.m.)

2 THE COURT: For the record, this is the matter of
3 the *United States versus Richard Petix*. Come on up, Mr.
4 Petix. For the record, you are Richard Petix?

11:06:44AM 5 THE DEFENDANT: Yes, your Honor.

6 THE COURT: And you are appearing with your
7 attorneys Mr. Lembke and Mr. Leonardo; is that correct?

8 THE DEFENDANT: Yes, your Honor.

9 THE COURT: Mr. Resnick is here on behalf of the
11:06:56AM 10 Government, and Ms. Carducci is here, and Special Agent
11 Breckler. Is it Breckler?

12 SPECIAL AGENT BRECKLER: Breckler, yes, your Honor.

13 THE COURT: How do you say it?

14 SPECIAL AGENT BRECKLER: Breckler.

15 THE COURT: Breckler. Sorry. Special Agent
16 Breckler. And Mr. Spogen and Ms. Hernandez are here on behalf
17 of probation. This matter is on for sentencing. In that
18 regard, I have received and reviewed the following: The
19 revised presentence report dated August 3, 2017, the

11:07:21AM 20 Government's statement with respect to sentencing factors
21 dated July 17th, 2017, the original statement with respect to
22 sentencing factors and objections Mr. Lembke submitted dated
23 July 28, 2017. However, based on our conversations last time
24 in court, Mr. Lembke did submit an amended supplemental

11:07:46AM 25 objection to the PSR along with the statement for parties with

1 respect to the sentencing factors dated August 18, 2017. I
2 have the Government's original statement with respect to
3 sentencing factors dated July 17, 2017, and the response to
4 the original objections filed by the defendant dated
11:08:10AM 5 July 30th, 2017. I, additionally, have the Government's
6 response to the defendant's amended objections to the
7 presentence report dated August 28th, 2017. And I have
8 subsequent to that a statement -- statement sentencing
9 memorandum submitted by Mr. Leonardo dated September 1st,
11:08:33AM 10 2017, with a number of exhibits including transcript excerpts
11 and letters written by Dinah, is that how you say it?

12 THE DEFENDANT: Yes, your Honor.

13 THE COURT: Your fiancée, your mother, your dad,
14 and your brother Christopher Petix. Now just for purposes of
11:08:54AM 15 the record, Mr. Resnick, has the Government received the
16 presentence investigation?

17 MR. RESNICK: Yes, your Honor.

18 THE COURT: Mr. Lembke, have you received the
19 amended report?

11:09:04AM 20 MR. LEMBKE: Yes, I have.

21 THE COURT: And have you gone over it with
22 Mr. Petix?

23 MR. LEMBKE: He received a copy of it.

24 THE DEFENDANT: Yes, your Honor.

11:09:11AM 25 MR. LEMBKE: Yes, your Honor.

1 THE COURT: You read it yourself; is that correct?

2 THE DEFENDANT: Yes, your Honor.

3 THE COURT: Okay. Now, I think I have a handle on

4 this. And I have some understanding I think or appreciation

11:09:25AM 5 of the objections. We will go through them in a second. Let

6 me ask you it this, Mr. Resnick, and feel free to throw a

7 lifeline out to Ms. Carducci or Special Agent Breckler. If I

8 buy Bitcoins today, okay, I have Bitcoins. And I want to hang

9 onto them. And then I want to sell them to Mr. Lembke for a

11:09:48AM 10 profit. Is that a money transmitting business?

11 MR. RESNICK: I would have to maybe just on those

12 facts, maybe it's not, but --

13 SPECIAL AGENT BRECKLER: Your Honor --

14 THE COURT: Help us out.

11:10:03AM 15 SPECIAL AGENT BRECKLER: -- with respect to that

16 part of the 18 USC 1960, is that you are acting as a business.

17 So if you are to do it one time --

18 THE COURT: No, I'm not saying one time. If you

19 did it -- if -- here is what I'm saying --

11:10:17AM 20 SPECIAL AGENT BRECKLER: If you did it multiple

21 times --

22 THE COURT: Let me finish. If I make my living by

23 selling -- by buying -- we know Bitcoins fluctuate. I think

24 when this originally happened, one Bitcoin was \$3,400. I went

11:10:31AM 25 online today. They are like \$4,000, one Bitcoin today. So I

1 decide, hey, understanding they fluctuate and I could end up
2 getting hosed, but I decide I'm going to buy Bitcoins and I'm
3 going to make my living by buying Bitcoins and then selling
4 them for a profit. Is that a money transmitting business? I
11:10:52AM 5 do it multiple times. Yes or no.

6 SPECIAL AGENT BRECKLER: Yes, your Honor, if you do
7 it multiple times --

8 THE COURT: All right. Let me stop you.

9 MR. RESNICK: Can I just add on that?

11:11:00AM 10 THE COURT: No, let me just -- because here is the
11 second circuit case that Mr. Lembke relies on it's *United*
12 *States versus V-E-L-A-S-T-E-G-U-I*. And here is what it says.
13 It's charged under the same section. The case involves the
14 money -- business of money transmitting. Okay? Here is what
11:11:23AM 15 the Second Circuit said, "a money transmitting business
16 receives money from a customer, and then for a fee paid by the
17 customer, transmits that money to a recipient in a place that
18 the customer designates usually a foreign country. After the
19 customer gives the money transmitter an amount to send to the
11:11:45AM 20 designee, the transmitter notifies the payer with whom it has
21 a contractual arrangement in the recipient country. The payer
22 then notifies the designated recipient of the money and pays
23 the money to the designee at the payee's office."

24 So here is my question, and this is a point made by
11:12:05AM 25 the defense, and this is consistent. Mr. Leonardo, I don't --

1 and again, Mr. Resnick, if I knew before I went through this
2 last night that this was going to be an issue, I would have
3 told you.

4 MR. RESNICK: I will have something to add to it
11:12:24AM 5 when you give me a chance.

6 THE COURT: Okay. And I just want to point out
7 something that Mr. Leonardo said because he referred to the
8 federal statute and said it makes reference to the state
9 statutes in New York and NYCRR. And one of the things he
11:12:44AM 10 cites is exception from the licensing requirements. The
11 following persons are exempt from licensing requirements
12 otherwise applicable under this part. Now this is in
13 reference to the state law, but it says "merchants and
14 customers that utilize virtual currency solely for the
11:13:00AM 15 purchase or sale of goods or services or for investment
16 purposes." And I may have this wrong, but it strikes me that
17 the defense argument is this: We know that the defendant
18 plead guilty to engaging or operating an unlicensed money
19 transmitting business beginning on or about August 2014 and
11:13:30AM 20 continuing to on or about December 3rd, 2015. He plead guilty
21 to that. I haven't seen the transcript because it's not ready
22 at the plea but either Mr. Lembke or Mr. Leonardo, I forget
23 which, makes reference to the fact that he admitted to
24 engaging in one transaction during that time, I think; is that
11:14:00AM 25 correct, Counsel?

1 MR. LEONARDO: That's correct, your Honor.

2 MR. LEMBKE: At least one.

3 THE COURT: At least one, but there was no amount
4 ever specified.

11:14:06AM 5 MR. LEMBKE: That's correct.

6 THE COURT: Okay. So there is no amount specified.

7 So there was never any admission on the record that the money
8 transmitting business activities that he engaged in involved a
9 certain amount of money. They are coming back and saying --

11:14:20AM 10 Mr. Leonardo in his papers says, listen, his adjusted offense
11 level on Count Two, the best we can be is 14 because you
12 should back out the \$87,000 or so that resulted from
13 transactions with CD-1 or confidential informant one or two,
14 whatever it was, because he's saying that that doesn't fit the
11:14:48AM 15 definition of a money transmitting business. And the argument
16 is just because you plead guilty during this time frame to
17 operating a money transmitting business, doesn't mean that any
18 transaction you had with Bitcoins violates the statute. That
19 strikes me as his argument. Is that correct, Mr. Leonardo?

11:15:07AM 20 MR. LEONARDO: I think that's a fair
21 interpretation, your Honor.

22 THE COURT: Mr. Lembke --

23 MR. RESNICK: There is another argument that it was
24 also double counting.

11:15:12AM 25 THE COURT: Forget the double counting because I

1 think this is a critical argument.

2 MR. RESNICK: Sure.

3 THE COURT: Mr. Lembke I thought goes even farther,
4 and he says you can't -- you are talking about the 109 -- and
5 I know I have the numbers wrong -- but the \$109,000 in the
6 Bank of America account. You are talking about the \$87,000
7 more or so that resulted in these. That's great, he says, but
8 you can't show how much of that money was a result of a money
9 transmitting business. You can't show that. You don't know.

11:15:41AM 10 And let me make this point: Let's stop a second. Let me ask
11 you this, Mr. Resnick, and then I will give you a chance. Is
12 there any evidence that the transactions involving the
13 confidential -- I think you referred to them as confidential
14 informants -- were in effect as a result of operating a money
11:16:06AM 15 transmitting business where the only thing the PSI says that
16 Mr. Petix sold Bitcoins to these individuals? It wasn't --
17 and again, I'm pointing out the definition in the Second
18 Circuit case which is consistent with the Fourth Circuit case
19 that a money transmitting business means that for a fee I
11:16:31AM 20 transmit money to a third party or entity. So were those
21 transactions -- and we will start with Mr. Leonardo's
22 position. He says those transactions have not been proven by
23 a preponderance of evidence to be within the gambit of this
24 money transmitting business.

11:16:57AM 25 MR. RESNICK: If I may, I have a few arguments.

1 First, is that he did plead guilty to a money laundering
2 business which he would--

3 THE COURT: Transmitting business.

4 MR. RESNICK: Transmitting business which you would
11:17:06AM 5 just logically conclude is more than one. A business is not
6 one transaction.

7 THE COURT: Okay. Let's say it was 20
8 transactions.

9 MR. RESNICK: Okay. So we have 20 transactions or
11:17:14AM 10 whatever.

11 THE COURT: Whatever. Okay.

12 MR. RESNICK: Second of all, the way I understand
13 this is an investor, let's say, it's a stock investor. It's
14 the same thing to me. You have stock. You buy it from a
11:17:27AM 15 brokerage. And then when you want to sell your stock, I go to
16 Fidelity. And I put in there, and the market takes it, and
17 sells it, and gives me whatever the price is. I don't sell my
18 stock to Mr. Lembke. Okay? I'm not in the business of
19 selling stock individually like a brokerage firm or something
11:17:47AM 20 who is in the business of selling stock. I buy stock as an
21 investor on the market, and I sell it in a brokerage. Now,
22 there is a company called Coinbase which the defendant
23 actually used which when you buy a stock -- buy Bitcoins, you
24 buy it from them. And then you can go and sell it to them
11:18:05AM 25 when you want to sell it at a higher price. Now, what that

1 does is that records the sale. My stock will be recorded, and
2 it's not anonymous. So if he did his transactions as a
3 legitimate investor and do it through Coinbase, you don't have
4 to drive to Buffalo. You don't have to go and find CDs, these
11:18:24AM 5 confidential informants, to sell my stock to Mr. Lembke.

6 THE COURT: Let me just stop you right there
7 because I want to go back to the Second Circuit case and I
8 want to repeat it. A money transmitting business receives
9 money, and then for a fee paid by a customer, transmits the
11:18:42AM 10 money to a recipient in a place that the customer designates.
11 So I say to you so what. So what. So what if he wanted to go
12 to Buffalo and in a back alley sell his Bitcoins to
13 Mr. Lembke, and he made a profit from them. So what.
14 Obviously, he made a heck of a profit in a few transactions.
11:19:06AM 15 They totaled \$87,000. And again, it looks like Special Agent
16 Breckler is chomping at the bit so you can certainly confer
17 with him.

18 MR. RESNICK: I want to finish my arguments, if you
19 don't mind just so we can have a complete record.

11:19:17AM 20 THE COURT: Sure. Not at all.

21 MR. RESNICK: So my argument then would be he could
22 have gone to probation and asked for permission to use a
23 computer to sell stock or Bitcoin through a brokerage right
24 from his bedroom or from wherever his phone was or whatever
11:19:30AM 25 permission he had on any media. He didn't have to go and find

1 individual buyers. What he did is use another company called
2 Local Bitcoin that is an anonymous way to sell these things.
3 There is no tracking. There is no trace of them. That's my
4 understanding that's what he used. Again, I've got an
11:19:49AM 5 advertisement. He advertised his business on the website or
6 whatever at the Local Bitcoin. He has an advertisement to
7 sell Bitcoin if I can hand this to the Court. We took a text
8 off his phone when he was arrested and in the text it says to
9 whoever he is talking to it says, "Sounds like a deal I can't
11:20:16AM 10 refuse. Over time, you will see that I value our business
11 relationship much more than stealing \$3- to \$700 one time and
12 ruining such a good thing." Because the way they do it,
13 you've got to be together because you got to get the cash and
14 you got to get the Bitcoins at the same time, or you could rip
11:20:35AM 15 somebody off and say, "Hey, give me your \$700," and then I
16 won't give you the bit -- you don't give the Bitcoins, and the
17 guy is out \$700. In here, they are talking about their
18 business relationship. And again, why, if this is a
19 legitimate investor is he doing it behind probation's back?
11:20:54AM 20 And when caught says this is not my computer. These flash
21 drives are not mine. I was not selling Bitcoin. I mean,
22 Judge, you have to circumstantially look at the situation
23 here. He was conducting something under the radar, and it
24 fits within the definition.

11:21:12AM 25 THE COURT: How does it fit? I am going to come

1 back to this. And let me quote the Fourth Circuit case which
2 cites the Second Circuit case a money transmitting business,
3 and that's what he is charged with running. He has admitted
4 that during the time frame he was running a money transmitting
11:21:30AM 5 business. The point I'm trying to make is how do you show --
6 they are objecting. They are saying that you can't show --
7 again, little different arguments -- Mr. Leonardo is saying
8 you can't show that the \$87,000 that he made in those three
9 transactions was a money transmitting business. And

11:21:52AM 10 Mr. Lembke is going farther, and he is saying you can't show
11 what amounts of the 108 -- 202,000, whatever it is, was from a
12 money transmitting business.

13 MR. RESNICK: But, your Honor --

14 THE COURT: Here is what they are saying, though, A
11:22:10AM 15 money -- and this is what the Fourth Circuit says, "a money
16 transmitting business is one that, for a fee, accepts currency
17 for transfer within or out of the United States and then
18 transfers it out." Same definition for the Second Circuit.
19 How is he doing that? How is -- and let me make it simple.

11:22:28AM 20 It seems that a in money transmitting business there have to
21 be three entities: The person who wants the money transferred
22 to a third person, the person who is going to transfer the
23 money, and that third party. And if there is only two, I
24 don't care whether it's -- I'm not saying I'm right, but this
11:22:50AM 25 is how I read the case. If there is two, I don't care whether

1 the sale occurs in a back alley at midnight. I don't in care
2 if it occurs without a broker. If there is only two people
3 involved, then it's not -- I mean, the argument that they are
4 making is that it's not a money transmitting business. Again,
11:23:08AM 5 did you have a chance -- I don't know if you had a chance yet
6 -- did you have a chance to look at Mr. Leonardo's papers?

7 MR. RESNICK: I did, your Honor. And I was going
8 to ask a question. I mean, I would assume this supercedes the
9 other prior filings. You can't have two different filings by
11:23:23AM 10 two different attorneys in the same case making two different
11 arguments. So I think it was the Government's assumption that
12 the law figure they were arguing was at least 116 plus the
13 13,000.

14 THE COURT: Well, it was somewhat confusing, but
11:23:34AM 15 the point I want to make in referring to Mr. Leonardo's papers
16 is the one that I referred to. And here's what he is saying
17 --

18 MR. RESNICK: Where are you at?

19 THE COURT: I'm on page -- it's not numbered, but
11:23:48AM 20 mine is page four at the top. It starts at paragraph 22 and
21 then goes down. Reading from title in paragraph 23. Title 18
22 Section 1960 is relevant here provides. And then the key part
23 is B and fails to comply with the money transmitting business
24 registration requirements under Section 5330 of Title 31 of
11:24:18AM 25 the United States Code. It goes on in paragraph 24, Title 31

1 Section 5330 is relevant provides here. And then it goes
2 down. And the italics, I assume, is part of the statute; is
3 that correct, Mr. Leonardo?

4 MR. LEONARDO: That's correct.

5 THE COURT: It says that "this section shall not be
6 construed as superseding any requirement of the state law
7 relating to money transmitting businesses operating in such
8 state." And then he goes on in paragraph 25 to talk about New
9 York law and regulations. And then on the next page under
10 subparagraph C-2, he holds that consumers that utilize
11 merchants and consumers that utilize virtual currency solely
12 for the purchase or sale of goods or services for investment
13 purposes. In other words, there is no licensing requirement.
14 And that's the same argument that Mr. Lembke is making. And
15 again, it goes back to the fact they are saying that if I sell
16 -- I will make it simple. If I just sell to a third -- to one
17 other person, there is only two people, and the buyer doesn't
18 say I want you to transmit this money to a third party, and
19 the money that I'm making is the profit that I'm getting from
20 when I bought the Bitcoins to when I sold them, and I'm not
21 getting a fee to transmitting them to a third party, it would
22 appear that under the Second Circuit's definition that's not a
23 money transmitting business. Agent Breckler?

24 SPECIAL AGENT BRECKLER: Your Honor, with respect
25 to the initial transactions with CD-1, I can say that while

1 they were -- they were not initially face-to-face off of this
2 Local Bitcoins website. So this Local Bitcoins website, to
3 further explain this, it's a place where users can buy and
4 sell Bitcoins. Normally as a fee, so I have to go through and
11:26:26AM 5 see what the market rate was at the time of the transaction
6 versus what the advertisement --

7 THE COURT: You are missing the point. If the
8 purchaser is the end guy -- if the purchaser of the Bitcoins
9 -- that's where the Bitcoins are going to stay.

11:26:45AM 10 SPECIAL AGENT BRECKLER: I understand that, your
11 Honor. What Mr. Petix had to do in each one of these
12 transactions is send these Bitcoins from his wallet to a third
13 party, Local Bitcoins, to hold those Bitcoins in escrow. And
14 then once the transaction had been verified by Mr. Petix, he
11:27:03AM 15 had received cash either at a face-to-face cash meet at a
16 location or when he had the \$109,000 deposited into his bank
17 of America account and his fiancée's account, then he would
18 verify yes I received this money. Local Bitcoins would take a
19 fee. Mr. Petix -- I don't know because I don't have his whole
11:27:28AM 20 history because it is semi --

21 THE COURT: You are missing the point. It's him
22 taking the fee. The definition of the money transmitting
23 business, the way I read it -- and again, I'm just going with
24 what the Second Circuit says. I'm not bound by it. It says
11:27:42AM 25 that if you are running a -- here is what it means if you are

1 running a money transmitting business. It means that you --
2 that somebody comes to you and says, for example, listen, I
3 want to get -- I want to get \$50,000 to my brother-in-law in
4 Yemen. Can you help me out? And I say yes, I can. If you
11:28:02AM 5 give me two -- 2,500, I'll take care of it. That's not what
6 happened here. That's not what happened here. So unless --
7 you're going to have to convince me that what he was running
8 was a money transmitting business as it has been defined by
9 the Second Circuit. That's the hurdle and --

11:28:23AM 10 MR. RESNICK: Judge, doesn't his plea of guilty
11 admit that he -- he admitted that he was running a money
12 transmitting --

13 THE COURT: Absolutely. It admits that during the
14 time frame -- that's their argument that during the time
11:28:33AM 15 frame, he was operating a money transmitting business.

16 MR. RESNICK: And circumstantially, if you look at
17 the way he tried to hide it, and using advertisements, and
18 even talking about a business relationship, if you use that
19 circumstantially and his admission that he was running a
11:28:46AM 20 business, why would he run a business for one transaction but
21 be an investor for every other one?

22 THE COURT: Let me stop you. Let me stop you for a
23 second. I am going off the PSI. The way the PSI presents it
24 is that he sold to -- and let me read from the PSR. I'm
11:29:22AM 25 reading from paragraph 54. Cooperating defendant, CD-1,

1 identified Petix via a six pack photo line up. CD1 was a
2 Buffalo based Bitcoin exchanger who had several hundred
3 thousands of dollars in transactions. CD stated that he or
4 she met Petix for the purpose of buying Bitcoins between
11:29:42AM 5 August 22nd, 2014, and October 15th, 2015, on 14 occasions.
6 CD purchased approximately 199 Bitcoins with an approximate
7 value of \$56,360 from Petix. That's what it says in the PSR.
8 That's what it says. And I'm telling you if that's what
9 happened unless you can show me how that fits the
11:30:04AM 10 definition -- no one is objecting. Let me stop. No one is
11 objecting to the statement in the PSR.

12 MR. RESNICK: He plead guilty to running a
13 business.

14 SPECIAL AGENT BRECKLER: Your Honor, I can show
11:30:16AM 15 that because I can go back and look at the accounts I have for
16 CD-1 and show that at sometimes he paid 102 percent of what
17 the market rate was which would be that fee.

18 THE COURT: Let me stop you. First of all, the
19 objections have been in. The case was cited by Mr. Lembke. I
11:30:37AM 20 am saying that I don't see how that -- how what -- objections
21 could have been made to the PSR by the Government. I'm saying
22 I don't see how the statements in the PSR, the unobjected
23 statements in the PSR, on what he did with respect to the
24 \$87,000 amounts to running a money transmitting business. You
11:31:07AM 25 are right. And here is the point I think you are missing, the

1 defense is not suggesting that he didn't operate a money
2 transmitting business during that time. What they are
3 arguing, and maybe this is more of the point, is that not
4 every time he sold -- he exchanged Bitcoins was not a money
5 operating business.

6 MR. RESNICK: And the argument to that is we have a
7 preponderance of evidence, not beyond a reasonable doubt, you
8 know --

9 THE COURT: Right.

10 MR. RESNICK: He plead to a money laundering
11 business -- or a money transmitting business, guilty. Now
12 prove Government not all of these transactions were part of
13 it, but he used the same method and means. So if he's using
14 the same method and means to sell --

15 THE COURT: Identify for me one transaction that --
16 you never pinned him down.

17 MR. RESNICK: We are using his plea agreement. His
18 plea to I ran a money transmitting business. And he did every
19 transaction the same way using -- not the way a normal
20 investor would do it, but using Local Bitcoins. Isn't that

21 circumstantially enough to say that everything they did --

22 THE COURT: But here -- well, let's carry your
23 argument to its logical conclusion. If during that time there
24 was undisputable proof that Mr. Petix sold me Bitcoins.

25 That's it. He just sold me Bitcoins. You say that is part of

1 the money transmitting business.

2 MR. RESNICK: I would say if he used the same means
3 which is Local Bitcoin, and he did it face-to-face, and the
4 way he did it. And he plead guilty to that, he admitted that
11:32:37AM 5 the way he is --

6 THE COURT: Let me stop you.

7 MR. RESNICK: At least one of those transactions
8 the way he did it is illegal. We showed -- and we can show
9 that he did all of those transactions the same way.

11:32:51AM 10 THE COURT: Well, you haven't shown that. But
11 we're at sentencing and no one has shown that to me. But you
12 are still missing the point. If -- how -- it doesn't -- what
13 he did then -- if what he did doesn't fit the definition of a
14 money transmitting business, is any -- and this is what I'm
11:33:16AM 15 asking you. Is any transaction involving Bitcoins, whether it
16 fits the definition or not, that occurred during the time
17 frame of, what, August to whatever, December, is he
18 accountable to that?

19 MR. RESNICK: Your Honor, he has two experienced
11:33:31AM 20 lawyers and with their advise --

21 THE COURT: That's the argument.

22 MR. RESNICK: -- he plead guilty to running the
23 business.

24 THE COURT: You're not answering my --

11:33:39AM 25 MR. RESNICK: And if he plead guilty -- he should

1 then not have plead guilty because there's no proof based on
2 what you're reading that he conducted a business. But based
3 on his advise from his attorneys, he's admitting that he does
4 not fit in that definition in the Second Circuit that he did
11:33:51AM 5 conduct a money transmitting --

6 THE COURT: That's not what they are saying. I'm
7 trying to deal with the objections. That's exactly what they
8 are saying in the objections. They are saying -- what they
9 are saying is listen we are objecting. He plead guilty. The
11:34:06AM 10 dispute is over the amount for which he should be held
11 accountable.

12 MR. RESNICK: And my argument would be just like if
13 he was convicted at trial of running a business, I would then
14 go to the jury and say hey he did everything the same way,
11:34:20AM 15 every transaction basically the same way. So if you found him
16 guilty of doing one transaction --

17 THE COURT: The PSR doesn't establish he did every
18 -- I don't know how he did the --

19 MR. RESNICK: Well, we are having a hearing right
11:34:30AM 20 now, and we are establishing that. How do you want us to
21 establish that? He did every transaction basically the same
22 way.

23 SPECIAL AGENT BRECKLER: Basically the same way,
24 your Honor. I just want, for the record, there was the
11:34:37AM 25 face-to-face versus the cash into his Bank of America account.

1 Those are two different types of transactions. They both use
2 --

3 THE COURT: Okay. Stop. You're telling me. Wait
4 a second.

5 MR. RESNICK: It's the same thing. The same
6 company except not just the face-to-face.

7 THE COURT: Stop. You are telling me he did every
8 transaction the same way and your agent is saying, well, that's
9 not correct. He didn't do every one the same way. Some he
10 did face-to-face and some he did otherwise. But we are still
11 -- I'm trying to deal with the objections that they made.

12 MR. RESNICK: Well, I think the bottom line is we
13 made our arguments. He conducted -- I think the best argument
14 we have is he's admitted to doing this. And the way he did it
11:35:10AM 15 then by a preponderance of evidence he did basically the same
16 thing for every transaction. One was face-to-face. One was
17 he would require the cash to go into his bank account first
18 for the Bitcoins, but he is basically using the same company,
19 the Local Bitcoins --

20 THE COURT: Just show me --

21 MR. RESNICK: And that is our argument. And that's
22 all I can keep saying to you.

23 THE COURT: Stop.

24 MR. RESNICK: He plead guilty.

25 THE COURT: I understand that.

1 MR. RESNICK: If a jury found him guilty, I would
2 argue --

3 THE COURT: Stop. Time out.

4 MR. RESNICK: Yeah.

11:35:32AM 5 THE COURT: Just show me where on Mr. Xiang's
6 papers he makes that argument. He had a chance to respond to
7 the objections.

8 MR. RESNICK: What argument is that, your Honor?

9 THE COURT: The argument that you are making that
11:35:42AM 10 each was done the same way, maybe he did, and I missed it.

11 MR. RESNICK: I'm reading on page three the thing
12 that was filed on August 28th.

13 THE COURT: All right. Let's look at the
14 August 28th filing.

11:36:01AM 15 MR. RESNICK: I'm looking at the second page the
16 first full paragraph which says "the defendant turned to a
17 different platform, Local Bitcoins, for his business. He
18 advertised his service to strangers across the business which
19 I showed you some of his advertisements. He arranged late
11:36:23AM 20 meetings, travelling. He also took anonymous precautions."

21 So we are setting forth that he is doing this basically for
22 every transaction the same way using that platform that is
23 anonymous. So he plead guilty. A jury would find him guilty.
24 I would argue to the jury that everything is very similar. So
11:36:39AM 25 therefore, all of the transactions beyond a reasonable doubt

1 are part of this fraud. Circumstantially, I mean, why would
2 he plead guilty to doing one but not the others if the others
3 are done the same way. So that's our argument.

4 THE COURT: I'm just trying to say. Let's think
11:36:59AM 5 about that because you raised a good point. We go to trial.
6 We are at trial. You're right. He plead guilty.

7 MR. RESNICK: Same as a trial verdict.

8 THE COURT: All right. But we are at trial. Okay?
9 You show -- what are you going to show that he did these
11:37:12AM 10 transactions, basically, the same way even though some were in
11 person some were not, that he dealt with these individuals?

12 And then we get -- and then we get -- because you
13 brought up the trial, now we get to my instructions. And I
14 say here is what you have to find. They have to prove beyond
11:37:32AM 15 a reasonable doubt that he was running a money transmitting
16 business. This is what it means. Here is how the Second
17 Circuit has defined a money transmitting business.

18 The jury comes back and says what if we don't find
19 that he transferred them out to a third party for a fee.
11:37:45AM 20 Let's say we are at trial, Mr. Resnick, and you are the judge,
21 and the jury puts that question on you. And they say, Judge,
22 here is how you define a money transmitting business. What if
23 we don't find that there was any evidence that for a fee he
24 sent money to third party? What do you tell them?

11:38:05AM 25 MR. RESNICK: If that is the law as you say, then

1 he would be acquitted. But we are beyond that. He plead
2 guilty.

3 SPECIAL AGENT BRECKLER: There is evidence though
4 --

11:38:15AM 5 THE COURT: One at a time.

6 MR. RESNICK: Judge, he plead guilty. So we are
7 already at the verdict of the trial. The jury has found him
8 guilty as the same as him pleading guilty. So whatever -- his
9 guilty plea is admitting that he fits within the elements of
10 this crime. Now that he's admitted to the elements of this
11 crime, we're showing that he's done this numerous time,
12 basically, the same way. So therefore, circumstantially, all
13 of those other transactions -- all of these transaction fit
14 within the same pattern just like any scheme, just like any
11:38:27AM 15 scheme to defraud. You know, you show it. It's the same
16 pattern, restitution. We are always arguing relevant conduct.
17 That is what we are doing here. He plead guilty to it. If
18 what you are saying is true, he should not have plead guilty
19 to it. But his lawyers advised him, and he plead guilty.

11:38:44AM 20 THE COURT: Maybe, I don't know. Maybe, I mean,
21 maybe we should have plead down at the plea what transactions
22 he did. Maybe the Government should have said, you know what,
23 Judge, ask him this. What transactions, specifically, were
24 you here during the plea? Mr. Xiang was anxious to get it
11:39:02AM 25 done. And we had some discussions. And I asked him is that

1 sufficient. And he said yes. So all he did was admit that
2 during that period of time -- I thought it was one
3 transaction, maybe he said more than one.

4 MR. RESNICK: He said at least one, I think.

11:39:34AM 5 THE COURT: At least one. He could have said, your
6 Honor, we need -- and I distinctly remember asking Mr. Xiang
7 is that enough from the Government's point.

8 MR. LEMBKE: I remember that too.

9 THE COURT: Presuming he was comfortable with it.
11:39:48AM 10 It's a different issue now. You are suggesting that because,
11 and I'm going back to it. I am not saying you are right or
12 wrong. But what your argument is is that any transaction
13 involving Bitcoins that he conducted during that time should
14 factor into the amount. And I'm not sure you are right. Now,
11:40:05AM 15 Mr. Lembke and Mr. Leonardo, I will give you a chance to make
16 an argument. I understand the Government's position.

17 MR. LEMBKE: Judge, you have articulated our
18 argument. One thing that we do want to address, however, is
19 what was brought up about the fact that it seems as though
11:40:27AM 20 Mr. Leonardo and I have inconsistent positions in connection
21 with the loss amount. I think that what his point -- you
22 explain it to him, Steve.

23 MR. LEONARDO: Judge, if I may --

24 THE COURT: I understand his point. I think it is
11:40:45AM 25 time served.

1 MR. LEONARDO: Judge, our positions are not
2 inconsistent. I took what appeared to me to be the most
3 obvious. There is a hand-to-hand sale of Bitcoin, and the
4 Government likes to emphasize the word business and that he
11:40:59AM 5 advertised his business. The business is advertised. But the
6 key and emphasis should be on money transmitting. He was not
7 the money transmitter. Whatever he sold Bitcoin for was what
8 a willing purchaser was going to pay. And on many instances,
9 the one specifically I refer to in my sentencing memo, they
11:41:14AM 10 were a hand-to-hand sale. The method by which he transferred
11 the Bitcoin is the only method by which it can transfer. It's
12 virtual. It doesn't exist. It has to be transferred in the
13 way he transferred it. It doesn't make what he did a money
14 transmitting business. I don't see any dispute. I don't
11:41:31AM 15 think there can be any sincere dispute that those hand-to-hand
16 sales could not constitute --

17 THE COURT: Let me put you on the spot for a
18 second.

19 MR. LEONARDO: Okay.

20 THE COURT: Because Mr. Resnick raises a good
21 point. Why did he plead guilty? If he didn't -- I'm not
22 saying you have to answer that out loud. It's more of a
23 rhetorical question.

24 MR. LEONARDO: Thank you.

11:41:49AM 25 THE COURT: But Mr. Resnick posted why did he plead

1 guilty if all he was doing was making money from selling
2 Bitcoins? You knew the definition of -- presumably, you were
3 aware of the definition of a money transmitting business. And
4 he said that on at least two -- if I take what you gave me now
11:42:08AM 5 and with a plea what you said is at least on one occasion he
6 transferred -- somebody came to him, asked him to transfer
7 Bitcoins to a third party, and that's when he did for a fee.

8 MR. LEMBKE: Yes, that's why he pleaded guilty, but
9 that's why he did not plead guilty pursuant to an agreement.

11:42:36AM 10 Mr. Resnick points at an accusing finger at us saying well he
11 pleaded guilty and therefore you are in for a penny, you are
12 in for a pound. Well when you plead guilty to an agreement,
13 part of the reason you plead guilty to an agreement is because
14 you want to contest certain aspects of the sentencing that you
11:42:59AM 15 would not otherwise be able to do with a plea agreement. So
16 he pleaded guilty because he did on at least one occasion make
17 a transfer for a fee. That's all he has admitted. And that's
18 all that's required under the statute. There is no minimum
19 amount.

11:43:17AM 20 THE COURT: I'm just trying to remember because I
21 didn't have -- I don't recall. And that's why I was trying to
22 get the plea. I don't recall what he said. Did he say on the
23 plea that he did, in fact, accept the fee and transfer money
24 to a third party?

11:43:32AM 25 MR. LEMBKE: On at least one occasion.

1 THE COURT: Right, but did he say that's what he
2 did?

3 MR. LEONARDO: No, I think he said he operated a
4 money transmitting business on at least one occasion.

11:43:45AM 5 MR. LEMBKE: With the understanding of what a money
6 transmitting --

7 THE COURT: No. And again, it's a shame that
8 Mr. Xiang didn't clarify that because at that time I didn't
9 have the definition of a money transmitting business because
11:44:00AM 10 we could have perhaps clarified a lot. Again, I distinctly
11 remember asking Mr. Xiang is this good enough. Is the
12 Government satisfied with this? And he said yes.

13 MR. RESNICK: But again, your Honor, that's just
14 the elements. And the elements were covered by what
11:44:21AM 15 Mr. Lembke said and that's all that is required. We were not
16 talking about relevant conduct at that time.

17 THE COURT: There is no question. But if the
18 relevant conduct, if in other exchanges in Bitcoins he was not
19 acting as a "money transmitter" because it didn't go to a
20 third party, then those amounts -- and that's precisely the
21 objection the Government is making --

22 MR. LEMBKE: The defense.

23 THE COURT: That those amounts -- excuse me -- the
24 defense is making that those amounts -- you can't identify out
11:44:49AM 25 of, for example, the Bank of America account. And here is

1 another interesting thing, the Court did sign a preliminary
2 forfeiture order.

3 MR. RESNICK: Yes, I was going to bring it up, your
4 Honor. It was not contested.

11:45:05AM 5 THE COURT: It wasn't contested. Here is what's
6 interesting, Mr. Peterson found that in drug cases there is a
7 rebuttable consumption. I'm looking at 21 USC Section 853
8 subsection D. There is a rebuttable presumption at trial that
9 any property of a person convicted of a felony under this
11:45:31AM 10 subchapter is subject to forfeiture of this section if the
11 United States establishes by a preponderance of evidence that,
12 one, such property was acquired by such person during the
13 period of the violation of the subsection two or within a
14 reasonable time after such period, and two, there was no
11:45:47AM 15 likely source for such property other than the violation of
16 the subchapter.

17 Now, I mention that because there is a principle
18 called expressio communis exclusio alterius. And essentially
19 it means that if it's stated in one place and not stated in
11:46:21AM 20 another, it means it was not intended by the legislature to be
21 included. And a lot of the special agents' affidavit in
22 support -- and you're right. It was not contested. And I
23 don't know if I signed the final order, but it wasn't
24 contested. And I know a lot of special agents affidavit goes
11:46:36AM 25 precisely to this, the timing of this. And I'm wondering and

1 I was asking is there a section, a similar presumption, that
2 applies to situations like this?

3 MR. RESNICK: I think, your sentencing relevant
4 conduct section.

11:46:57AM 5 THE COURT: But do you understand what I'm saying?
6 There is a specific presumption that says okay if you came
7 into money during the time that you admitted to dealing drugs,
8 and there is really no source for the money other than you
9 can't show -- then it's forfeitable. But I don't know if
11:47:14AM 10 there is a similar presumption that applies to this section.

11 MR. RESNICK: But I think our preliminary order of
12 forfeiture that you signed goes beyond that. And it even says
13 that the government has established between the property and
14 the offense committed was \$189,000.

11:47:31AM 15 THE COURT: Right. And I signed it probably
16 because there was no objection.

17 MR. RESNICK: But that -- I mean, again, that's
18 like a guilty plea. It's like --

19 THE COURT: You're right, Mr. Resnick, but I don't
11:47:42AM 20 know the effect of a criminal preliminary order.

21 MS. CARDUCCI: Your Honor, yes, on that Section 21
22 USC 853 that does apply to all forfeiture actions.

23 THE COURT: It does?

24 MS. CARDUCCI: It does, yes. It's applicable to
11:47:53AM 25 all forfeiture actions. There is a section that makes it

1 applicable to all forfeiture under all statutes. So that
2 presumption would apply in the case.

3 MR. LEMBKE: Is there a final order?

4 MS. CARDUCCI: No, the final order would get issued
11:48:10AM 5 after sentencing.

6 THE COURT: Correct. So could you just maybe,
7 Ms. Carducci, it would be helpful if you provided the Court
8 and counsel with that section. And that raises the issue if
9 it's forfeitable and there is a guilty plea, does that lend --
11:48:28AM 10 does that aid the Government in their position? So what Ms.
11 Carducci is saying is there is this rebuttable presumption.

12 MR. LEMBKE: I understand.

13 MR. LEONARDO: If the defendant challenged this
14 point -- if the defendant, for whatever reason, chose not to
11:48:40AM 15 challenge the forfeiture --

16 THE COURT: It does not say that.

17 MR. LEMBKE: No, it's --

18 THE COURT: Here is what it says. It says that any
19 person convicted of a violation of the subchapter, blah, blah,
11:48:58AM 20 blah, any property constituting or derived from any proceeds
21 the person obtained directly or indirectly as a result of such
22 violation. So the argument that I assume the Government would
23 make and it kind of juxtaposing Mr. Resnick is saying is this:
24 That since he plead guilty, if this rebuttable presumption
11:49:21AM 25 applies, then the presumption -- the rebuttable presumption --

1 again, I am just going off on comparable cases maybe it's
2 sufficient at the end of the day unless it's rebutted.

3 MR. LEMBKE: Unless we object to it.

4 THE COURT: Well, I don't know if objecting to it
11:49:42AM 5 is the same as -- I don't know the answer. Is that the same
6 as rebutting it? I mean, it's a rebuttable presumption. As a
7 matter of fact, if you are saying well this shouldn't apply,
8 I'm not sure I know the answer to that.

9 MR. LEMBKE: Yes, you're right. It's two different
11:49:59AM 10 burdens. Their burden here in terms of sentencing is to
11 establish by a preponderance of evidence to relevant conduct.
12 Our burden according to that would to bring forth evidence to
13 rebut a presumption.

14 THE COURT: No, their burden -- so the argument
11:50:14AM 15 that kind of Mr. Resnick has made and Mr. Xiang has made is
16 this: That it is their burden to show the property they seek
17 to forfeit is the proceeds of criminal conduct by a
18 preponderance of the evidence. That's the verdict.

19 MR. LEMBKE: Yes.

11:50:31AM 20 THE COURT: Okay. And they are suggesting that
21 there has been no objection to the forfeiture of the money.
22 No objection was filed.

23 MR. LEMBKE: Yes.

24 THE COURT: So based on the fact that no objection
11:50:44AM 25 was filed, I -- and again, I don't know effective or the

1 preliminary order of the forfeiture is, but they are saying at
2 least preliminarily I found by a preponderance of evidence
3 that the money of \$189,000 they are seeking to forfeit was the
4 proceeds of the crime to which the defendant did the crime.
11:51:06AM 5 That's their argument.

6 MR. RESNICK: And I would just add that --

7 MR. LEMBKE: I understand.

8 MR. RESNICK: -- if you are an investor of this
9 doing this legally and properly, you could say give me my
11:51:14AM 10 money back.

11 MR. LEMBKE: You don't know that we are not going
12 to say that.

13 MR. RESNICK: I'm just saying --

14 THE COURT: Listen. Let's all step back a second.

11:51:22AM 15 This is not a simple case. In retrospect, I'm sure the
16 Government would have done things differently and clarified
17 some issues, but it is what it is now. So I'm just trying to
18 clarify -- I think I have a good handle on the defense
19 arguments. I've clarified it. Again, if Ms. Carducci is
11:51:42AM 20 correct --

21 MS. CARDUCCI: I have the section for you, your
22 Honor.

23 THE COURT: What is it?

24 MS. CARDUCCI: It's 18 USC Section 982(b).

11:51:49AM 25 THE COURT: 18 USC Section --

1 MS. CARDUCCI: 982(8) subsection B and that
2 basically says that any forfeiture under the provisions of 982
3 incorporates 853. So the presumption you were citing under 21
4 --

11:52:08AM 5 THE COURT: So what you are saying is any criminal
6 forfeiture under any criminal case incorporates this
7 presumption?

8 MS. CARDUCCI: Yes, but particularly the forfeiture
9 in this case was under Title 18 USC 982, and there is a
11:52:23AM 10 provision under 982 that indicates that the provisions of 21
11 USC 853 applied forfeitures under 982. So that presumption
12 would be applicable in this matter.

13 THE COURT: So again, I don't know -- again, I
14 don't recall Mr. Xiang -- I know Bitcoins were going for
11:52:46AM 15 \$3,400 a piece at the time. I don't know if the Government in
16 their submission has established -- I think you can recall in
17 your submission Special Agent Breckler, did you point out that
18 the defendant had no other sources of income?

19 SPECIAL AGENT BRECKLER: In my affidavit, your
11:53:01AM 20 Honor, I would have to reread my affidavit.

21 MR. RESNICK: Your Honor, he did file a probation
22 report every month saying he had no income. He was working
23 for his father for very little money not \$189,000 worth. I
24 can show you the probation reports where he signed under
11:53:17AM 25 penalty of perjury.

1 THE COURT: No. Let's assume that's correct, Mr.
2 Lembke. So here is the Government's counter-position.

3 MR. LEMBKE: Yes.

4 THE COURT: The Government's counter-position is if
11:53:27AM 5 you find -- and I will make it as simple as I can.

6 MR. LEMBKE: Yes.

7 THE COURT: If you find by a preponderance of
8 evidence that \$189,000 is forfeitable because it's the
9 proceeds of the crime, that is tantamount to finding that
11:53:42AM 10 \$189,000 should be attributable as relevant conduct to
11 Mr. Petix by a preponderance of evidence. I am not saying
12 they are right or wrong. I don't know the answer to that.
13 But here is what I'm going to do, in the event -- if, for
14 example, I were to back out the hand-to-hand -- I'm not saying
11:54:02AM 15 I would -- but if I were to back out the hand-to-hand sales as
16 Mr. Leonardo correctly points out, then the guidelines -- the
17 top end of the guidelines would be 24 months; right? Isn't
18 that what you calculated?

19 MR. LEONARDO: At that level, Judge, it may be
11:54:20AM 20 lower than that. It would be no more than that.

21 THE COURT: Let me go back to this because there is
22 another issue that I have. And let me try to identify this
23 because some things are not issues. To the extent, for
24 example, Mr. Lembke, I decide that any of your comments about
11:54:35AM 25 you shouldn't include this description of the dark web. I

1 don't have to strike that. I can just say it's not going to
2 effect me in sentencing. It's not going to. The other big
3 issue is the two point -- and the argument that the Government
4 really has on this two point enhancement, I think, Mr. Spogen
11:55:10AM 5 distinctly sets forth in --

6 MR. SPOGEN: Paragraph 54, your Honor.

7 THE COURT: Yes. I mean in addition, this is the
8 compelling thing. In addition, CD-1 purchased approximately
9 199 Bitcoins with an approximate value of \$56,360 from Petix.
11:55:36AM 10 In addition, the Government advised that on September 7th CD-1
11 sent a message to the defendant which read I stopped selling
12 coin to the public because I didn't want any trouble from the
13 state IRS. I wouldn't risk it with New York State. Okay.

14 Then it goes on to say that despite knowing this that the
11:56:02AM 15 customer's Bitcoin activity entailed trouble with the state
16 and federal authorities, the defendant conducted five more
17 transactions totaling approximately \$75,000. And I say so
18 what. So what if I'm the buyer and I say I am going to stop
19 doing these because it might get me in trouble and I say, eh,
11:56:27AM 20 I want to do some more. How is that attributable to Mr.

21 Petix? How does that in any help that he knew the guy was
22 committing criminal activity? I think I put the Government --
23 and again, Mr. Resnick, help me out if I'm remembering this
24 wrong. I think I asked Mr. Xiang, you know, you threw in your
11:56:46AM 25 papers that he sold to somebody that bought marijuana who

1 obviously the Government is working with, it would be easy.
2 Have me say that guy said I'm going to use the Bitcoins to buy
3 marijuana, or I'm going to use the Bitcoins to engage in
4 illegal activity, but there is no evidence of that.

11:57:06AM 5 SPECIAL AGENT BRECKLER: Your Honor, if I can speak
6 to CD-2 who we are talking about the marijuana. CD-2, in my
7 conversations with CD-2 and recently and throughout the entire
8 time with CD-2, when he brought up what he was going to buy
9 with the Bitcoins, Mr. Petix said I don't want to know. I
11:57:24AM 10 don't want to get in trouble is what CD-2's statement was. So
11 because it is a cash for currency transaction, a money meet is
12 what it is, Mr. Petix was insulating himself. He knew what
13 CD-2 was going to do. And when he stopped --

14 THE COURT: Okay. That's a sell. I mean, it would
11:57:47AM 15 be easy if he said -- you said CD-2 wanted to tell him what he
16 was going to do. Did he tell him?

17 SPECIAL AGENT BRECKLER: He never -- he stopped
18 him.

19 THE COURT: How could he stop him?

11:57:56AM 20 SPECIAL AGENT BRECKLER: Mr. Petix stopped him
21 because he didn't want -- because they were doing business.

22 THE COURT: You understand none of this is in the
23 PSR, but even if it was -- so I'm the purchaser of the
24 Bitcoins, and I say I want to use them for, and Mr. Petix says
11:58:12AM 25 don't tell me.

1 MR. RESNICK: Your Honor, that's one argument.
2 There is another argument if you look on our response which
3 was -- our first response on July 30th, 2017, there is a
4 footnote there. And it basically said the evidence shows that
11:58:29AM 5 the defendant knowingly used Tor in his unlicensed money
6 transacting business. In a text message he kind of referenced
7 this to CD-1 that they are using Tor. Now, Tor is used, I
8 believe, in the darknet.

9 Now the darknet is underneath the regular net and
11:58:48AM 10 that's where people buy drugs, CP, all kinds of illegal
11 activity. He is using an operating system that gets him into
12 the darknet. I don't know if I'm explaining it right and
13 maybe the agent can explain it.

14 THE COURT: Well, I guess the question kind of
11:59:06AM 15 becomes then and maybe this is an issue on -- where is the
16 footnote? I'm sorry, Mr. Resnick. Can you just direct me,
17 please?

18 MR. RESNICK: It's on the first filing by the
19 Government by July 30th, 2017.

11:59:15AM 20 THE COURT: What page?

21 MR. RESNICK: Page six. And again, remember, I
22 mean, I know you are saying it's not in the PSR, but again, we
23 were not objecting to the PSR because the probation department
24 found it on a different basis. So that's fine with us as long
11:59:31AM 25 as there is a basis for it. They objected. Now we responded

1 to their objection.

2 THE COURT: The defendant objects to claiming there
3 is no evidence that he was accessing the darknet or using the
4 Tor browser. To the contrary, the evidence shows that the
11:59:40AM 5 defendant knowingly used Tor in his unlicensed transmitting
6 business. The text message on August 26th, 2014, to CD-1
7 about technically only using Tor circumventing New York
8 State's bit license for regulatory scheme. The defendant
9 wrote it won't be hard to set-up a Bitcoin wallet entails so
12:00:04PM 10 it automatically connects to Tor and never goes to NYS. When
11 he transferred 37 Bitcoins to the undercover agent on
12 December 3rd, 2015, the defendant followed his own advise. He
13 used a Bitcoin wallet stored on the thumb drive using the
14 tails operating system thereby automatically connecting via
12:00:32PM 15 Tor. And that footnote tells me that all you can buy on the
16 darknet is illegal stuff?

17 SPECIAL AGENT BRECKLER: No, the Government is not
18 saying that, your Honor.

19 THE COURT: That's what the Government just said.

12:00:47PM 20 MR. RESNICK: I said there is illegal stuff in it,
21 and I would say a lot, probably the majority, because there is
22 no reason to be on the darknet if you are doing legitimate
23 business.

24 THE COURT: Well, somebody must be on the dark net
12:01:02PM 25 doing legitimate business.

1 MR. RESNICK: Well, then the defendant must be.

2 SPECIAL AGENT BRECKLER: Your Honor, I mean, the
3 darknet is a whole different discussion.

4 THE COURT: The dark net and the deep web are the
12:01:11PM 5 same thing?

6 SPECIAL AGENT BRECKLER: No, they are not, your
7 Honor. So the internet is broken down into the index web and
8 the unindex web. The unindex web is the deep web.

9 THE COURT: The index web is what Mr. Resnick and I
12:01:21PM 10 go on; right?

11 SPECIAL AGENT BRECKLER: Exactly, but when you say
12 you are here at your office, and you are on your DOJ computer,
13 and you are entering your internet web, interweb, that's
14 actually the deep web. That's a portion that's unindexed
12:01:34PM 15 because I can't at my house access your DOJ e-mail. You can't
16 access your e-mail at your house.

17 THE COURT: Right. Yes.

18 SPECIAL AGENT BRECKLER: So that's technically the
19 deep web. Now within the deep web, there is a section called
12:01:51PM 20 the dark web marketplaces and hidden services. And it's
21 through these hidden services that we talk about these darknet
22 marketplaces which is throughout the affidavits where the
23 majority if not -- I don't want to say all of the business, 99
24 percent of the business is illegal on these darknet
12:02:09PM 25 marketplaces. In order to access these darknet marketplaces,

1 you need a -- you need to access them using a dot onion
2 website instead of a dot com site. Tor is one of the most
3 commonly used devices. So instead of using Google Chrome or
4 Internet Explorer, you click on the little button that's
12:02:30PM 5 called Tor.

6 THE COURT: Where do you find Tor?

7 SPECIAL AGENT BRECKLER: Actually, the Department
8 of Navy started it.

9 THE COURT: No, but I mean have you ever seen Tor
12:02:37PM 10 on your --

11 SPECIAL AGENT BRECKLER: You have to go on Google.

12 THE COURT: Is it an app you download?

13 SPECIAL AGENT BRECKLER: Literally, it's an app.
14 It has become so advance there are apps for your smartphone.

12:02:48PM 15 THE COURT: So if I go to the app store, I can
16 download Tor?

17 SPECIAL AGENT BRECKLER: If you go to the app store
18 on your phone, you would most likely download an Orbot for
19 your phone. If you go on your computer, you would just go on
12:03:04PM 20 Google and you would type in Tor. It will take you to the Tor
21 Project. And then you just click. If you had the admin.
22 rights to your computer, you can install Tor.

23 MR. RESNICK: Then it becomes a program on your
24 computer. So you have to download it on your computer.

12:03:15PM 25 THE COURT: No, I get that like Safari.

1 SPECIAL AGENT BRECKLER: Yes. So what that does
2 and what the defendant is saying here is he is walking CD-1
3 through, hey, I understand New York State has come up with
4 this Bit license that a majority of this community was acting
5 as money service businesses on the surface web got scared
6 about. With this, he walks him through here is how you show
7 your IP address so you are no longer in New York State. You
8 are in some foreign country or outside of New York State by
9 accessing Tor when you are going through your transactions.

12:03:31PM

12:03:50PM

10 Because what Local Bitcoins did is if you were posting an ad
11 acting as money services to sell your Bitcoins for a fee on
12 that website, they stopped letting people in New York State do
13 that if your IP address came back to New York State.

12:04:09PM

14 MR. RESNICK: And he is advertising it. So I guess
15 our argument is saying using Tor software gets you to the dark
16 web, and he knows people are using Tor. He is telling people
17 to use Tor, and that's where you buy illegal products.

12:04:24PM

18 SPECIAL AGENT BRECKLER: Additionally, your Honor,
19 through the December 3rd transaction with the undercover
20 agent, when I did an analysis of the Bitcoin addresses that
21 came from Mr. Petix to our undercover agent, compliance
22 software used by the industry, the Coinbase company that we
23 talked about previously, shows that the majority of those 37
24 Bitcoins or roughly \$13,000 came directly from these darknet
25 places.

12:04:50PM

1 MS. CARDUCCI: Your Honor, may I just put something
2 on the record? I want to make it clear. Is that okay?

3 THE COURT: Of course.

4 MS. CARDUCCI: Join the party; right?

12:04:58PM 5 THE COURT: Yes. Sure.

6 MS. CARDUCCI: With regard to our motion for
7 preliminary order of forfeiture, we did set out that the total
8 value involved in the defendant's illegal unlicensed money
9 transmitting business was \$189,000. The defense never
10 objected to that amount and that's why you did enter the
11 preliminary order forfeiture after 14 days because they never
12 filed an objection. So I just want to make that clear.

13 THE COURT: All right, which takes us to a point --

14 MR. RESNICK: Your Honor, I will also mention in
12:05:30PM 15 the plea agreement in the indictment that he plead guilty to
16 we have the forfeiture allegations.

17 THE COURT: Not the amount.

18 MS. CARDUCCI: Not the amount, but our motion we
19 did set forth the amount and attach the agent's affidavit and
12:05:43PM 20 how we came up with that amount.

21 THE COURT: So what is your position? Is that some
22 type of judicial omission on the defendant's part? If he
23 didn't object -- so read the language again.

24 MS. CARDUCCI: Your Honor, we set forth in the
12:05:54PM 25 preliminary order forfeiture that \$189,862.96 was the total

1 value of Bitcoins transmitted by the defendant.

2 THE COURT: That are forfeitable.

3 MS. CARDUCCI: Yes, your Honor.

4 THE COURT: And explain to me how you forfeiture.

12:06:12PM 5 Did you serve a copy of that on the defendant?

6 MS. CARDUCCI: Yes, your Honor. We e-filed it just
7 like we do with all of our motions. Defense counsel received
8 a copy of that. They had 14 days to respond. They did not
9 file an objection. So after that 14 days had passed, we

12:06:27PM 10 submitted the preliminary order of forfeiture to your Honor
11 and you signed that. And that was obviously e-filed, and
12 defense counsel had knowledge of that.

13 THE COURT: Here is the issue I want addressed, and
14 maybe you are right, is that in effect a judicial admission on
12:06:43PM 15 the defendant's part that that amount of money was
16 forfeitable? If it was, then it would be case closed because
17 if you are saying that amount is forfeitable, it is only
18 forfeitable if it's the proceeds of illegal activity.

19 MS. CARDUCCI: I would say yes, your Honor, because
12:07:01PM 20 they didn't object to it.

21 THE COURT: I understand your position. I'm just
22 looking for some law that supports that. So here is what I am
23 going to do now. Even if I were to hold Mr. -- and I'm
24 looking at my guidelines. It's undisputed that his criminal
12:07:17PM 25 history category is three. If he -- if I declined, as

1 Mr. Leonardo urges to, even though it's an additional two
2 points relating to those transactions involving informants,
3 his offense level would be 14; correct?

4 MR. LEONARDO: Correct.

12:07:42PM 5 THE COURT: If I -- even if I gave him the two
6 points for having some knowledge that would be engaging in
7 criminal activity, that would raise him to a 16, but then
8 lower it again to a 14 because he gets two points acceptance.

9 MR. RESNICK: I don't believe so.

10 THE COURT: Why?

11 MR. RESNICK: He is not accepting responsibility at
12 all for the crime.

13 THE COURT: No, that's not true.

14 MR. RESNICK: Well, I mean, they are saying there
12:08:12PM 15 is no loss here. There is no transactions.

16 THE COURT: Well, that's another issue, but I
17 can't -- the PSI recommends reduction for the sentence.

18 MR. RESNICK: That was before the objections were
19 filed.

12:08:26PM 20 THE COURT: Well, his objections are to the --
21 typically, you're right, Mr. Resnick. Objections -- and
22 that's another thing that you can address. I will give you a
23 chance to do that because what Mr. Resnick is referring to,
24 Mr. Lembke, is the acceptance has to extend to relevant
12:08:44PM 25 conduct. And if it doesn't extend -- I think it says if he

1 falsely or something denies relevant conduct, that can be a
2 basis for denying acceptance. I am just pointing out if
3 Mr. Leonardo is correct, then the range that he would be
4 looking at is 21 to 27 months. The most he can get on a
12:09:04PM 5 violation of probation is 10 months under the guidelines.

6 MR. RESNICK: Yes.

7 MR. LEMBKE: Under the guidelines.

8 THE COURT: That's 37 months. What's 85 percent of
9 37 months?

12:09:16PM 10 MR. LEMBKE: I have it.

11 THE COURT: It's only --

12 MR. LEMBKE: 31.3 months.

13 THE COURT: 31.3. If they win their objection

14 on -- I'm not saying they will -- but if they win their

12:09:32PM 15 objection and it goes down two points because I don't apply

16 it, then we are getting to a point where he can be in for time
17 served. So what I'm going to do is --

18 MR. RESNICK: It's 27 plus the 10 which you are

19 saying is 37 months. That would be the high end of the

12:09:48PM 20 guideline range.

21 THE COURT: That would be the total high end of the
22 guideline assuming --

23 MR. RESNICK: Then he would have 31 months. I'm

24 sure he is getting good time. So why don't we sentence him

12:10:00PM 25 right now, 37 months.

1 MR. LEONARDO: No, 31.

2 MR. RESNICK: Well, you know, 37. He gets the --
3 you'll get the 31. He has been in for how long?

4 MR. SPOGEN: Almost 22, 21 months 12 days.

12:10:20PM 5 THE COURT: I mean if you want if everyone agrees,
6 I will sentence him to time served.

7 MR. LEONARDO: We agree.

8 MR. RESNICK: No, we do not agree to time served.

9 THE COURT: All right. Then what I'm going to do
12:10:23PM 10 is we can flush out these issues. I'm going to release
11 Mr. Petix under the same conditions that he was released on.

12 Here is what I want to address. And I think it
13 will legitimately deal with some issues. Ms. Carducci is
14 suggesting -- what Ms. Carducci is suggesting, Mr. Lembke and
12:10:48PM 15 Mr. Leonardo, just so we are clear, is the fact that he did
16 not object despite giving notice to the amount sought to be
17 forfeited is in effect an admission that \$189,000 is the
18 amount involved in relevant conduct. That is issue number
19 one. Okay? So I'd like -- and we will set a schedule. Some
12:11:18PM 20 may be right, some may be wrong. I'm not sure.

21 Second issue, Mr. Resnick is suggesting that by
22 contesting the amount -- and \$189,000 would get him to the 12
23 point increase; is that right?

24 MR. SPOGEN: Ten point, your Honor, yes.

12:11:39PM 25 THE COURT: Would get him to the maximum --

1 MR. SPOGEN: Anything over 150, your Honor.

2 THE COURT: Would get him to the 10 point increase.

3 Okay. Mr. Resnick is suggesting that I should deny him.

4 What's the acceptance section?

12:11:54PM 5 MR. SPOGEN: 3E1.19(a), Judge.

6 THE COURT: All right. Let's take a look at 3E.

7 MR. RESNICK: It is under application notes 1A.

8 THE COURT: Thank you, Mr. Resnick. It says, "in

9 determining whether a defendant qualifies under subsection A,

12:12:21PM 10 appropriate consideration should include but are not limited

11 to the following: Truthfully submitting the conduct comprised

12 in the offense of conviction and truthfully admitted,

13 admitting, or not falsely denying any additional relevant

14 conduct in which the defendant is accountable." So the

12:12:39PM 15 argument is that he is accountable for that amount. I'm not

16 saying it's right. He is falsely denying it. Now, again,

17 just a suggestion of avoiding further litigation, if you were

18 to get the top end of each guideline, Mr. Resnick, we are

19 talking about the total of 37 months. Assuming --

12:13:06PM 20 MR. RESNICK: No, that's with the two point

21 reduction.

22 THE COURT: The two point reduction. Let's look at

23 what his ultimate exposure would be. So if he withdrew, for

24 example, any objections to the amount, his offense level would

12:13:27PM 25 be 16, correct, Mr. Spogen, 6 and 10?

1 MR. SPOGEN: Correct.

2 THE COURT: He would get the two level increase for
3 knowing it was incorrect and then go back down to 16.

4 MR. SPOGEN: Correct.

12:13:47PM 5 THE COURT: So that would be 27. And tell me if I
6 am wrong, Mr. Spogen. That would be 27 to 30 months.

7 MR. RESNICK: Thirty-three.

8 MR. SPOGEN: Thirty-three, what was in the original
9 presentence report.

12:14:01PM 10 THE COURT: If he got the top -- I'm not saying he
11 is going to get it -- but if he got the top end of the
12 recommended guidelines on the violation and there is a
13 recommendation that it be run consecutive, I wouldn't sentence
14 him consecutively. I wouldn't exercise my discretion at
12:14:19PM 15 sentencing to sentence him consecutively on the crime because
16 it is the same conduct.

17 We have the other issue that he didn't -- that we
18 may have to litigate. That's another consideration. We may
19 have to litigate the issue. Remember one of the violations
12:14:31PM 20 stems from the fact that he would not provide probation, as
21 required, with the passwords for these thumb drives, but he is
22 taking -- at least counsel is taking the position that they
23 were not his thumb drives. They were his girlfriend's. So we
24 may have to litigate that issue. So let's assume after the
12:14:50PM 25 litigation I decide to sentence him consecutively, and we are

1 looking at the total, I applied the high end of the guidelines
2 of 43 months; right? So what's 85 percent of 43? Is it
3 something like 34 months? Can you do it, Mr. Lembke.

4 MR. LEMBKE: Of 43?

12:15:27PM 5 THE COURT: Eighty-five percent of 43, is it 34?

6 MR. LEONARDO: Thirty-five, thirty-six months.

7 THE COURT: So 46.

8 MR. LEONARDO: Thirty-six.

9 THE COURT: Thirty-six. So he has 22 in. I mean,
12:15:41PM 10 certainly, if Counsel were to agree to some thing in the
11 mid-range and avoid any litigation -- I'm not saying you
12 should or shouldn't -- but the Court would probably be
13 receptive. In other words, we are going to adjourn this. And
14 I'm pointing out, Mr. Resnick, I'm not making any promises on
12:16:02PM 15 sentencing. I could give him top end. I could give him more
16 or less.

17 MR. RESNICK: Yes, I think there is grounds of
18 departure upward because of the fact that you gave him a break
19 on sentencing.

12:16:13PM 20 THE COURT: Right, but I have to give notice of
21 that before I do that and I haven't given any notice.

22 All I'm saying is if counsel want to meet and come
23 up with some suggestion to avoid further litigation, it might
24 involve slightly more time on Mr. Petix's part, but because
12:16:40PM 25 you haven't been sentenced, that could be done locally. And

1 it might obviate the necessity of hearings. I am not
2 suggesting you do that, but the Court is always receptive to
3 conversations between counsel.

4 But absent that, I'm going to issue a scheduling
12:17:00PM 5 order. And we are going to address -- and the big issue is
6 the one Ms. Carducci was kind enough to bring up. And that is
7 the fact that in the preliminary order of forfeiture without
8 objection, I found there is a preponderance of evidence for
9 the \$189,000 was a forfeitable amount. Does that foreclose
12:17:32PM 10 the defendant from now arguing a lesser amount? And if he
11 does, does that impact his ability that he continues to
12 persist? Does that impact his ability at sentence? So how
13 long? They can be letter memos.

14 And Mr. Resnick, and I certainly invite, you know,
12:17:57PM 15 the Government if they are disputing the definition of the
16 Second Circuit of money transmitting business that regardless
17 of when it is conducted you have to have some evidence that
18 the transactions involve sending Bitcoins to a third party.
19 Or again, Ms. Carducci's suggestion since that presumption
12:18:24PM 20 applies, does it somehow carry over to the sentencing. The
21 rebuttable presumption that these monies are the proceeds of
22 the crime. And that would be sufficient to carry the day to
23 show this is the amount. Let's face it. That's the amount.

24 So Counsel, since I'm going to let Mr. Petix out --
12:18:44PM 25 and let me tell you something clearly. Okay? I'm letting you

1 out, and I will tell you why because I'm not sure of exactly
2 what the law is. And it is at least possible -- and I don't
3 want you to do more time than you would otherwise have to do
4 on these issues. So I'm just trying to be fair to you. But
12:19:03PM 5 if you screw up on supervised release again, then you will be
6 back in. And I'm telling you -- although, Mr. Spogen, you
7 won't be around because you are bailing on all of us next week
8 -- Ms. Hernandez will be here. When you are released, which
9 facility are you at?

12:19:27PM 10 THE DEFENDANT: I'm at Monroe County Jail right
11 now.

12 THE COURT: So you will probably be released today.
13 Give me a time that he will be released. Will he be released
14 around 3:00?

12:19:36PM 15 MR. LEONARDO: Probably around there, Judge.

16 THE COURT: All right. I want you to report here
17 tomorrow morning to Mr. Hernandez and go over the conditions
18 of release. You know what they are. I'm tell you, if you
19 violate any condition of release, then a warrant.

12:19:59PM 20 And doing that I'm considering too what Mr.
21 Leonardo and what Mr. Lembke brought out in the presentence
22 report that unlike many of the individuals who stand convicted
23 of child pornography, and it has been determined you are not a
24 petaphile. There are still issues that remain that I don't
12:20:25PM 25 know what the Government is looking into. It is hard for me

1 to believe that -- what's the thing that Apple refused to
2 provide information on something and the Government can't get
3 into it -- and we can't get into these.

4 MR. RESNICK: We are going to resubmit them, Judge.

12:20:34PM 5 THE COURT: So that is one issue out there because
6 no commitment has been made concerning what's on those flash
7 drives if anything.

8 And the other thing is I don't know if the
9 Government is looking at -- I mean, Mr. Petix had a lot of
12:20:56PM 10 Bitcoins. The Bitcoins were going for \$3,400. In any event,
11 we will adjourn until -- how long do you need, Counsel, I know
12 you are going to want to turn this over to Mr. Xiang,
13 Mr. Resnick, and Ms. Carducci, I think.

14 MR. RESNICK: You may not want him back.

12:21:20PM 15 THE COURT: You are the supervisor. That is one of
16 the privileges of rank, you can delegate. So how about
17 30 days?

18 MR. RESNICK: Simultaneous filings?

19 THE COURT: Simultaneous filings within 30 days.
12:21:35PM 20 And then once I get the filings, I will schedule it. Does
21 that give you enough time, Mr. Leonardo and Mr. Lembke?

22 MR. LEONARDO: Are you good with that?

23 MR. LEMBKE: Depends on -- oh, to file.

24 THE COURT: To file and give an update. And please
12:21:46PM 25 a joint statement between counsel.

1 MR. LEONARDO: I understand. Thank you, your
2 Honor.

3 THE DEFENDANT: Thank you very much, your Honor.

4 THE COURT: So I don't lose track of it. Let's put
12:22:04PM 5 it on for a sentencing date after 30 days. Give me a week
6 after the 30 days. So we are going to put it on for a
7 sentencing date. You have 30 days. Hang on, Mr. Resnick.
8 Let's make sure the sentencing date works. So 30 days takes
9 us to what, Kathy, October 13th?

12:22:26PM 10 THE CLERK: Today is the 13th. A week after, so
11 that takes us to the 20th of October. We are on trial.

12 THE COURT: Let's go to the next week. What's the
13 trial the next week?

14 THE CLERK: A prisoner trial.

12:22:42PM 15 MR. LEMBKE: I'm in the trial that week.

16 MR. LEONARDO: What's the week?

17 MR. LEMBKE: October 23rd through Halloween.

18 THE CLERK: So November 1st?

19 MR. LEMBKE: I'm good on the first.

12:23:00PM 20 THE COURT: Okay. Put it on the first.

21 MR. LEONARDO: That's for sentencing, your Honor?

22 THE COURT: November 1st for sentencing. Again,
23 you better make Ms. Hernandez happy. Okay?

24 THE DEFENDANT: Yes, your Honor. Thank you.

12:23:15PM 25 MR. LEONARDO: Thank you.

1 (Whereupon, the proceeding concludes at 12:23 p.m.)

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REPORTER CERTIFICATE

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8

I, Briana L. Jeffords, do hereby certify that I did report
in stenotype machine shorthand the proceedings held in the
above-entitled matter.

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Briana L. Jeffords

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BRIANA L. JEFFORDS

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Freelance Court Reporter and
Notary Public No. 01JE6325111

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in and for Genesee County, New York

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